FISCAL NOTE

Bill #: SB5

Title: Establish employer/employee tax for general fund

Primary Sponsor: Sam Kitzenberg

Status: Introduced

Sponsor signature Date

Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY2003 Difference	FY2004 Difference	FY2005 Difference
Expenditures:			
General Fund (01)	$1,742,591	$1,548,207	$1,548,478
State Special Revenue (02)	$915,244	$1,220,325	$1,220,325
Federal Special Revenue (03)	$418,448	$557,931	$557,931
Proprietary (06)	$262,499	$349,998	$349,998
University Current Unrestricted (31)	$1,012,575	$1,350,101	$1,350,101
TOTAL	$4,351,357	$5,026,562	$5,026,833
Revenue:			
General Fund	$79,111,483	$111,776,731	$115,730,437
Net Impact on General Fund Balance:	$77,368,892	$110,228,524	$114,181,959

Yes	No		Yes	No	
	X	Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts
	X	Dedicated Revenue Form Attached		X	Family Impact Form Attached

Fiscal Analysis

ASSUMPTIONS:

1. This bill establishes an employer payroll tax at the rate of 0.8% of the employer's payroll, and an employee payroll tax at the rate of 0.32%. The bill also provides for a tax of 0.32% on the profit of sole proprietorships and the distributive shares of shareholders, partners, or member managers of S corporations, partnerships, and limited liability companies.
2. Wages paid to farm laborers, rail transport workers, civilian federal government employees, and military personnel are exempt from the tax.
3. The tax must be paid quarterly within 30 days of the end of each calendar quarter.

4. The tax takes effect October 1, 2002. There will be three quarters worth of collections in fiscal year 2003; including two quarters of actual collections, and one quarter of accrued revenue.
5. All collections of the tax are deposited in the state general fund.
6. Based on the most recent wage and salary data provided by the Bureau of Economic Analysis (BEA), it is estimated that the payroll tax base will be $9,507,087,000 in calendar year 2002; $9,878,002,000 in calendar year 2003; $10,248,917,000 in calendar year 2004; and $10,619,831,000 in calendar year 2005.
7. Based on the combined payroll tax rate of 1.12%; annualized employer/employee payroll taxes total $106,479,000 in calendar year 2002; $110,634,000 in calendar year 2003; $114,788,000 in calendar year 2004; and $118,942,000 in calendar year 2005.
8. Payroll tax liability for self-employed individuals is $4,500,000 in each calendar year.
9. *Total tax receipts for fiscal year 2003* are equal to one-quarter of calendar year 2002 employee/employer payroll tax ($26,620,000), plus one-half of calendar year 2003 employee/employer payroll tax ($55,317,000), plus one quarter of the annual tax from self-employed individuals ($1,125,000), or **$83,062,000**.
10. *Total tax receipts for fiscal year 2004* are equal to one-half of calendar year 2003 employee/employer payroll tax ($55,317,000), plus one-half of calendar year 2004 employee/employer payroll tax ($57,394,000), plus the annual tax from self-employed individuals ($4,500,000), or **$117,211,000**.
11. *Total tax receipts for fiscal year 2005* are equal to one-half of calendar year 2004 employee/employer payroll tax ($57,394,000), plus one-half of calendar year 2005 employee/employer payroll tax ($59,471,000), plus one the annual tax from self-employed individuals ($4,500,000), or **$121,365,000**.
12. Payroll taxes paid by employers are a deductible business expense. Business income subject to the corporate license tax and individual income tax will be reduced by the amount of the employer payroll tax. The corporate license tax rate is 6.75%, and the average marginal tax rate on income from unincorporated employers is 6.75%. Combined corporate license tax and individual income tax receipts will be reduced by $1,283,457 ((6.75% x 0.8% x $9,597,087,000)/4) for the final quarter of calendar year 2002, by $5,334,121 (6.75% x 0.8% x $9,878,002,000) for calendar year 2003, by $$5,534,415 (6.75% x 0.8% x $10,248,917,000) for calendar year 2004 and by $5,734,709 for calendar year 2005.
13. *The reduction in corporation license tax and individual income tax receipts in fiscal 2003* equals the reduction in the final quarter of calendar year 2002 ($1,283,457) plus half the reduction in calendar year 2003 ($2,667,061), or **$3,950,517**. *The reduction in fiscal 2004* equals half the reduction in calendar year 2003 ($2,667,061) plus half the reduction in calendar year 2004 ($2,767,208), or **$5,434,269**. *The reduction in fiscal 2005* equals half the reduction in calendar year 2004 ($2,767,208) plus half the reduction in calendar year 2005 (2,867,355), or **$5,634,563**.
14. All corporation license tax and individual income tax collections are deposited in the general fund. *The net increase in general fund revenue* is **$79,111,483** ($83,062,000 - $3,950,517) in fiscal 2003, **$111,776,731** ($117,211,000 - $5,434,269) in fiscal 2004, and **$115,730,437** ($121,365,000 - $5,634,563) in fiscal 2005.
15. The Department of Revenue would have to implement a computer system to process the new tax. Adding the new tax to the department's POINTS system would require expenditures of $668,664 in fiscal 2003 for contract programming services and ongoing expenditures of $153,688 for system maintenance beginning in fiscal 2004.
16. The Department of Revenue would have additional expenses of $24,480 per fiscal year to print and mail tax forms.
17. The Department of Revenue would hire three additional auditors in fiscal 2003 and a fourth additional auditor in fiscal 2004. The additional expenditure on personal services would be $99,539 in fiscal 2003, $134,329 in fiscal 2004 and $134,600 in fiscal 2005. Additional expenditures on equipment would be

$24,446 in fiscal 2003, $3,528 in fiscal 2004 and $3,528 in fiscal 2005. Additional operating costs would be $9,665 in fiscal 2003, $11,120 in fiscal 2004 and $11,120 in fiscal 2005.

18. FY02 expenditures on wages by state agencies were $146.8 million general fund, $146.7 million state special funds, $67.1 million federal special funds, $42.1 million proprietary funds, and $162.3 university current unrestricted funds.
19. State expenditures on wages will increase 4 percent if FY03 over the FY02 level.
20. All state agencies must pay the employer tax in the same manner the funds are used to pay employee wages.
21. There will be no direct impact on state general fund expenditures from tax payments made by schools or the university system.

FISCAL IMPACT:

	FY2003 Difference	FY2004 Difference	FY2005 Difference
FTE	3.00	4.00	4.00
Expenditures:			
Personal Services	$99,539	$134,329	$134,600
Operating Expenses	$702,809	$189,288	$189,288
Equipment	$24,446	$3,528	$3,528
Tax Payments	$3,524,563	$4,699,417	$4,699,417
TOTAL	$4,531,357	$5,026,562	$5,026,833
Funding:			
General Fund (01)	$1,742,591	$1,548,207	$1,548,478
State Special Revenue (02)	$915,244	$1,220,325	$1,220,325
Federal Special Revenue (03)	$418,448	$557,931	$557,931
Proprietary (06)	$262,499	$349,998	$349,998
University Current Unrestricted (31)	$1,012,575	$1,350,101	$1,350,101
TOTAL	$4,351,357	$5,026,562	$5,026,833
Revenues:			
General Fund (01)	$79,111,483	$111,776,731	$115,730,437
Net Impact to Fund Balance (Revenue minus Expenditure):			
General Fund (01)	$77,368,892	$110,228,524	$114,181,959
State Special Revenue (02)	($915,244)	($1,220,325)	($1,220,325)
Federal Special Revenue (03)	($418,448)	($557,931)	($557,931)
Proprietary (06)	($262,499)	($349,998)	($349,998)
University Current Unrestricted (31)	($1,012,575)	($1,350,101)	($1,350,101)
TOTAL	$74,760,126	$106,750,169	$110,703,604

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

Cities, counties, and school districts will experience significant increased costs to pay the .8% employer tax on wages.

LONG-RANGE IMPACTS:
The payroll tax will continue to grow over time along with growth in the payroll tax base.

TECHNICAL NOTES:
1. The tax applies beginning October 1, 2002; or for just one-quarter of calendar year 2002. The impacts in this bill assume that in order to administer the payroll tax for self-employed persons that the Department of Revenue will require the tax to be submitted on individual income tax returns for tax year 2002 on all income subject to the payroll tax for tax year 2002 at one-quarter the rate that would be in effect for the full year.
2. The definition of "employee" in this bill is modeled on the definition in the old fund liability tax. That tax was in the workers compensation chapter of Title 39 of the MCA, which includes a general definition of "employee". The definition of "employee" in the old fund liability tax extended that definition. This bill would codify the new tax in Title 15, which does not have a definition of "employee". In this context, this tax could be interpreted as applying only to those persons specifically included in the definition of "employee" in this bill rather than to those persons in addition to everyone included in the general definition in Title 39.
3. The definition of "wages" in Section 1(5) is not the same as the definition of "wages" for the individual income tax in MCA 15-30-201(7). This would require employers to calculate and report wages twice for tax purposes. It would be easier for employers to comply with this new tax if the definitions were the same.
4. In estimating system development costs, the Department of Revenue has identified the following risks: Estimated costs were derived without the use of ISTD/CIO recommended project methodology. Estimated elapsed time to implementation of 5 ½ months will introduce project risks and will not allow for the ITSD recommended project methodology. Adding this application onto the POINTS application may put at risk the goal of reaching POINTS stability by December 31, 2002 and implementation of POINTS Phase II (individual income tax and corporate license tax) in the fall of 2003.
5. The information technology project required to implement this legislation would require the review and approval of the Chief Information Officer as provided in 1-17-512, MCA.
6. As an alternative to adding this new tax type to the POINTS application, the department has requested an independent estimate of the costs to develop and implement a stand-alone computer system to administer the payroll tax proposed in this bill. The estimate provided does not constitute a bid but it does present an estimate of the cost of retrofitting the vendor's off-the-shelf software. This vendor's estimate is only one of potentially many vendors who may propose a solution and it is being provided here only to present an approximate cost. Actual cost of a computer system, if contracted for, must be determined according to the State's procurement laws and procedures.
7. The estimated cost to implement a stand-alone, modified, off-the-shelf solution would be $3.798 Million. Of this amount $3.0 Million is the vendor's estimated cost and $798,000 is the department's estimated costs to provide a project team and stage the development and implementation.